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California Hopes Bailout Will End Its Credit Crunch
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California hoped passage of the $700 billion rescue plan Friday would avert financial disaster for the most populous U.S. state, which a day earlier had called for a possible emergency federal loan. Its precarious financial position is an example of how the credit crunch has spread to states and municipalities.

California Gov. Arnold Schwarzenegger said the state is "not out of the woods yet." State Treasurer Bill Lockyer will go ahead with a planned $7 billion bond offering, but market conditions remain dire. "There are no guarantees the legislation will produce the market conditions that will permit completion" of the offering, Mr. Lockyer said in a statement.

Gov. Schwarzenegger said that if the state couldn't borrow on it's own, it would again "go to the federal government and ask for help." He had sent U.S. Treasury Secretary Henry Paulson a letter Thursday warning that California might have to seek $7 billion in emergency federal loans until liquidity is restored in credit markets.

With credit frozen, California had enough cash reserves to last until Oct. 28, said Tom Dresslar, a spokesman for Mr. Lockyer. As a result, the state was prepared to seek initial loans of between $1.5 billion and $2 billion to cover expenses including payrolls for thousands of teachers, police, firefighters and other public employees. Mr. Dresslar said $7 billion in federal loans might be needed before next spring, when new state tax revenue will be flowing.

But after the U.S. House of Representatives passed a revised version of the bailout plan that was signed by President George W. Bush on Friday, California's cash situation may be eased. Mr. Dresslar said the state is hopeful "the credit paralysis will end and we'll be able to access those markets the way we normally do." He added that the U.S. Treasury has the authority to grant an emergency loan for the state and that the rescue bill reinforces those powers.

Some other U.S. states, counties and municipalities also are feeling the effects of the credit crunch. Massachusetts this week postponed a $750 million offering and suspended a separate sale of commercial paper, after the state was only able to raise $232 million of its $400 million target for short-term cash needs. North Carolina's Cumberland County planned to borrow $27 million this month and refinance another $63 million for construction projects. But the state is unlikely to move ahead because of market conditions, said a county spokeswoman.

Florida also has had to delay issuing $200 million in 30-year municipal bonds, according to the director of the state's division of bond finance. The New Mexico Finance Authority, which is tasked with providing financing sources to communities, delayed a $24 million issue last week due to a lack of interest from banks, said Chip Pierce, a partner at Western Financial Group LLC, a financial-advisory company to state and local governments.

Getting new loans for California "will depend very much on how credit markets respond to the package, and how quickly that happens," said Michael Cohen, a budget analyst at the Legislative Analyst's Office in Sacramento, Calif. The state tries to keep about $2.5 billion in reserves, but a few times during the year, when tax revenue is lowest, California has to tap credit markets for short-term cash, he said.

Other states expect the crisis to continue. State Treasurer Dean Martin of Arizona said his state isn't hugely exposed to the credit market. But that's likely to change in coming months as Arizona confronts a budget shortfall of up to $1 billion for the current fiscal year and up to $2.5 billion for the next."We were in a very weak position going into this current crisis," Mr. Martin said. "The piggybank is empty and the credit cards are near their limits."

Arizona doesn't issue general-obligation bonds, so individual agencies are often required to essentially mortgage assets to cover shortfalls. "We can only assume they're going to have to get into the debt markets," Mr. Martin added."They've almost completely drained the rainy-day fund just to get through last year's budget."

At the local level, "there are examples every single day of counties hitting the wall," said Jacqueline Byers, research director for the National Association of Counties, an organization that represents 3,066 counties in the U.S. She said many counties that want to borrow are locked out of the bond market because there are few investors willing to buy. The cost of issuing new bonds has soared because of higher interest rates. "It's a mess," she said.

In California, property tax revenue is falling because plummeting home prices have resulted in lower assessments, even as cities are tied up by long-term labor contracts, said Mark Moses, chief financial officer for Stockton, Calif. That makes many California cities vulnerable to insolvency, he said.

Stockton faces a $16 million to $24 million shortfall on a $200 million operating budget this year. Mr. Moses said the city is looking at cuts in police- and fire-department budgets.

California officials see the city of Vallejo, Calif., as a troubled example of the financial crisis. Last month, a federal judge granted the city Chapter 9 bankruptcy protection. Vallejo, which is located north of San Francisco, buckled under the pressure of the real-estate bust, coupled with labor contracts that had built-in salary and benefits increases for police, firefighters and retirees. The city of about 120,000 residents is the highest-profile U.S. county or municipality to seek protection from creditors since Orange County, Calif., in 1994.

Some local governments are relatively liquid because they had been hoarding cash in anticipation of dealing with the state's budget shortfall and a long period of getting no state checks. Los Angeles County, for example, has $18 billion in cash and credit it can tap.

Still, Los Angeles County Treasurer Mark J. Saladino expects the credit crunch to eventually have an effect, since mutual funds and hedge funds, typically the biggest buyers of tax-free state, county and municipal debt, are no longer as active in the market. "That's a worry," said Mr. Saladino.

On Tuesday, he was able to roll over $10 million in tax-free commercial paper for about 30 days. "I breathed a sigh of relief after that," he said.

By Jim Carlton and Bobby White in San Francisco, and Gabriel Kahn and Ethan Smith in Los Angeles